

Letter of Findings: 09-0930
Gross Retail Tax
For the Years 2006, 2007, and 2008

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ISSUES

I. Manufacturing Equipment – Gross Retail Tax.

Authority: IC § 6-2.5-5-3(b); IC § 6-2.5-5-4; IC § 6-2.5-5-5.1; IC § 6-2.5-5-5.1(b); *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629 (Ind. Tax Ct. 1999); [45 IAC 2.2-5-8\(c\)](#); [45 IAC 2.2-5-8\(d\)](#).

Taxpayer argues that various items of lumbering equipment are exempt from sales/use tax because the equipment is directly used to manufacture finished lumber.

II. Administrative Correction.

Authority: IC § 6-8.1-5-1(c).

Taxpayer maintains that the audit made an administrative error which warrants correction.

STATEMENT OF FACTS

Taxpayer is an Indiana business which harvests timber for direct sale to its customers and harvests timber which is then processed in Taxpayer's sawmill to produce finished lumber. The Indiana Department of Revenue (Department) conducted an audit review of Taxpayer's business records. As a result of that review, the Department assessed additional sales/use tax. Taxpayer disagreed with a portion of the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives further explained the basis for the protest. This Letter of Findings results.

I. Manufacturing Equipment – Gross Retail Tax.

DISCUSSION

The Department found that Taxpayer had purchased certain items of equipment for which it had not paid sales tax at the time of purchase. Therefore, the Department assessed sales/use tax. Taxpayer disagrees stating that the equipment is exempt.

Taxpayer maintains that, as a manufacturer of lumber and hardwood products, certain materials and equipment are used for production activities and are subject to a sales and use tax exemption under IC § 6-2.5-5-3(b).

IC § 6-2.5-5-3(b) provides an exemption from sales and use tax for "manufacturing machinery, tools, and equipment... if the person acquiring the property acquires it for direct use in the direct production [or] manufacture... of other tangible personal property."

Property acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#).

[45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post-production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

IC § 6-2.5-5-4 provides an exemption for "[t]ransactions involving tangible personal property... if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described [IC § 6-2-5-2, 3]."

IC § 6-2.5-5-5.1 allows for the exemption of "tangible personal property... if the person acquiring the property acquires it for direct consumption as a material to be consumed in the direct production of other tangible personal property in the person's business of manufacturing [or] processing..." IC § 6-2.5-5-5.1(b).

As a threshold issue, it is the Taxpayer's responsibility to establish that the existing tax assessment is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." IC § 6-2.5-5-3(b), like all tax exemption provisions, is strictly construed against exemption from the tax. *Tri-States Double Cola Bottling Co. v. Dep't of State Revenue*, 706 N.E.2d 282, 283 (Ind. Tax Ct. 1999); *Mynsberge v. Dep't of State Revenue*, 716 N.E.2d 629, 636 (Ind. Tax Ct. 1999). Therefore, in order for the Taxpayer to establish that the equipment at issue is exempt, it must prove that the exemption is applicable.

A. Case Bulldozer. Taxpayer purchased a "Case" bulldozer. The audit report indicates that the bulldozer is

"used to clear a path and make a road out to and from the forest so that [T]axpayer can have access for transporting cut timber from [the] forest." The audit concluded that, "Although the dozer may be necessary purchase for the taxpayer, [it does] not have an immediate effect on the products being produced."

Taxpayer has provided photographs of the bulldozer "in action" along with a narrative of the manner in which the bulldozer is used in its lumber/sawmill operation. In this case, Taxpayer has met its burden of demonstrating that the bulldozer is used in an exempt manner because it is "directly used" in the "direct production of cut timber for sale to its customers or used to retrieve timber eventually processed into lumber at its sawmill."

B. Winch. Taxpayer purchased a "winch" which is attached to the Case bulldozer. The audit also found that the winch was not used to directly produce either cut timber or lumber. However Taxpayer has provided a brief narrative, documentation, and photographs establishing the manner in which the winch is "directly used" in the "direct production" of Taxpayer's products. As in the case of the Case bulldozer, Taxpayer has met its burden of establishing that the winch attached to the Case bulldozer is exempt.

C. Other Equipment. Taxpayer also argues that other items of equipment and associated parts are exempt. Among those items are forklifts and tires which – to one degree or another – are directly used within the "integrated production process" by which its lumber and wood products are produced. Taxpayer may well be correct but it is not possible to sustain Taxpayer on these issues based upon the information provided. On these issues, the Department is not prepared – on the basis of the information supplied during the administrative hearing – to second guess an auditor who spent substantial time preparing the audit report and engaged in extensive direct communication with Taxpayer's representatives.

FINDING

Taxpayer is sustained in part and denied in part. The Case bulldozer and the attached winch are exempt from sales/use tax.

II. Administrative Correction.

DISCUSSION

Taxpayer points to what it maintains is an error on the audit report. On page nine of that report, is listed an invoice from "Napa" and dated May 9, 2006. The audit lists the invoice cost as \$2,566. Taxpayer disagrees stating that the invoice is actually for \$25.66 and that the audit report simply made an error in entering the invoice. Under IC § 6-8.1-5-1(c), Taxpayer has met its burden of demonstrating that the entry – as entered on the audit report – is mistaken. The error should be corrected and the assessment adjusted accordingly.

FINDING

Taxpayer's protest is sustained.

SUMMARY

The Case bulldozer and the attached winch are exempt. The entry found on page nine of the audit report should be corrected, but in all other respects Taxpayer's protest is denied.

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